IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
OF PREMERA BLUE CROSS AND ITS AFFILIATES

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED RESPONSIVE TESTIMONY OF:

Audrey L. Halvorson
Senior Vice President and Chief Actuary
Premera Blue Cross

April 15, 2004

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<u>Introduction of Witness</u>

Q. Please state your name.

A. Audrey Lynn Halvorson

Q. Please identify your employer and state your title.

A. I hold the position of Senior Vice President and Chief Actuary with Premera Blue Cross.

Q. Are you the same Audrey Lynn Halvorson who filed direct testimony on March 31, 2004, in this proceeding?

A. Yes.

Q. Have you read the pre-filed direct testimony filed in this matter by the witnesses of the Office of the Insurance Commissioner, the state consultants, and the interveners in this proceeding?

A. I have read the pre-filed direct testimony that pertains to my area of testimony. In particular, I have read the pre-filed direct testimony of Lichiou Lee dated March 29, 2004, of James Johnsen dated March 31, 2004, and of Karen Perdue dated March 30, 2004. Lichiou Lee is an Actuary with the Insurance Policy and Rate Regulation division of the Washington State Office of Insurance Commissioner. James Johnsen and Karen Purdue are Vice President for Faculty and Staff Relations and Vice President for Health, respectively, for the University of Alaska.

Q. Do you have a response to any of the matters set forth in that direct testimony?

A. Yes. I would like to respond to testimony on the following subjects:

- Regulation of premium rates for coverage sold to individuals and regulated small group
- Concern about premium rates for the University of Alaska

<u>Regulation of premium rates</u>

Q. Do you agree with Lichiou Lee's testimony regarding the regulation of premium rates for coverage sold to individuals and regulated small groups in the state of Washington?

A. I generally agree with her testimony on that topic with a few clarifications that I describe below.

Q. Does Lichiou Lee's testimony support PricewaterhouseCooper's ("PwC") suggestion that Premera could, as a result of the conversion, increase premium rates for coverage to individuals and regulated small groups in eastern Washington while holding such rates steady in western Washington?

A. No. In fact, Ms. Lee's pre-filed direct testimony contradicts PwC's claim.

Q. Please explain.

A. PwC submitted reports in this matter entitled "Economic Impact Analysis of the Proposed Conversion of Premera Blue Cross for the State of Washington," dated October 27, 2003, and supplemented on February 27, 2004. The PwC reports suggest that Premera may be able to increase premium rates and operating margins in eastern Washington in the individual and small group lines of business, while maintaining current operating margins in western Washington, thereby increasing Premera's overall operating margins for individual and small group business. Ms. Lee's testimony, on the other hand, supports Premera's contention that Washington law does not permit the outcome contemplated by PwC.

In describing the permitted factors for adjusting the community rate, Ms. Lee states in Paragraph 7 of her pre-filed direct testimony that "before and after applying any factors, the projected premiums must be <u>revenue neutral; that is, under current demographic assumptions, carriers do not gain or lose the overall projected revenues before or after applying the factors</u>." (Emphasis added). She therefore supports

Premera's position that Premera cannot use any of the four allowable factors for adjusting the community rate, including the geographic area adjustment factor, to increase revenue to inflate overall margins.

The following simplified example using geographic area rating factors illustrates the point. Assume that monthly premiums in eastern and western Washington are $180 and $200 per member per month ("PMPM"), respectively, and that there are an equal number of members in the two areas. In this example the average revenue would be $190. If Premera were to change its geographic area rating factor for eastern Washington to increase premium rates to $185, then, according to Ms. Lee and Premera, premium rates in western Washington must decrease to $195 to meet the revenue neutrality requirement, keeping the average at $190. PwC, on the other hand, would have rates increase to $185 in eastern Washington and remain at $200 in western Washington, an average of $192.50, in violation of the revenue neutrality requirement of Washington law. PwC's belief that premium rates in eastern Washington for coverage sold to individuals and regulated small groups could go up, without a corresponding decrease in western Washington, is simply inconsistent with Washington law.

Q. Do you agree with Lichiou Lee's suggestion that a carrier might be able to increase operating margins in certain regions by reducing provider reimbursement schedules and not reflecting those reductions in the geographic area rating factors used to develop premium rates?

A. I agree that it might be possible for a carrier to increase operating margins in certain regions by reducing provider reimbursement schedules and not reflecting those reductions in the geographic area rating factors used to develop premium rates, but it is important to understand that the carrier's overall operating margin would not increase as a result. In her pre-filed direct testimony at Paragraph 7, Ms. Lee observes that carriers are not specifically required to update or modify their geographic area rating factors used in the development of premium rates, even if the relative provider reimbursement schedules by area change. She then infers that Premera's operating margins could increase in those regions where provider reimbursements decrease should Premera not reflect such decreases in its geographic area rating factors. That, however, is half the story. Because of the requirement that projected premiums be revenue neutral, as discussed previously, there must be offsetting decreases in operating margins in other areas. It is unclear to me how Ms. Lee's observations in this regard relate to Premera's conversion or the state consultants' reports or testimony.

University of Alaska premium rates

Q. James Johnsen and Karen Perdue of the University of Alaska suggest that increased premium rates for health care coverage resulting from Premera's conversion will impair the University of Alaska's ability of fulfill its educational mission on behalf of the state. How do you respond?

A. I do not believe that the conversion will have any effect on premium rates for the University of Alaska. In contrast, Mr. Johnsen reports that the University of Alaska spends $24,000,000 per year in employee health benefits with Premera and, applying figures from reports he has read, the conversion could increase that amount by as much as $1,200,000 per year. Mr. Johnsen is simply mistaken and he apparently misunderstands the financial arrangement between the University of Alaska and Premera.

The University of Alaska's health care coverage is administered by Premera under an alternative funding arrangement called Minimum Premium. Under this type of arrangement the University reimburses Premera for the actual health care claim costs incurred by members covered under the University's contract, much like an Administrative Services Only ("ASO") arrangement. The University of Alaska self insures for these claims; they are not insured by Premera. These health care claims costs are the largest portion of the University's health care expense and are not included in the premiums paid to Premera. The premiums paid to Premera are for administrative expenses and funding for a reserve pool used to smooth claim expense fluctuations for the University of Alaska.

Of the $24,000,000 in health care costs reported by Mr. Johnsen, I estimate that $22,000,000 is for health care claims expense for which the University of Alaska itself is the insurer. Premera's conversion cannot have an impact on these expenses any more than the conversion could impact the claims costs of any other insurer.

As a result, even if Premera were to increase rates for the University of Alaska at the highest level suggested by Mr. Johnsen,[1] the maximum increase would be approximately $82,000 per year, not $1,200,000.

Q. Does this conclude your pre-filed responsive testimony?

A. Yes, it does.

[1] Mr. Johnsen states that a 5 percent increase (for Alaska) is the highest found in the reports he has read. This purported increase presumably includes an increase in the Alaska premium tax rate. The University of Alaska is not subject to premium tax. Therefore, for purposes of this calculation, the 5 percent was reduced by 0.9%, an amount estimated by Reden & Anders, consultants to the Alaska Department of Insurance, as the impact on premium rates from a change in Premera's premium tax rate resulting from the conversion.

VERIFICATION

I, AUDREY L. HALVORSON, declare under penalty of perjury of the laws of the State of Washington that the foregoing answers are true and correct.

Dated this 15th day of April, 2004, at Naples, Florida.

/s/
AUDREY L. HALVORSON